Report by the House Small Business Committee
Democratic Staff
Nydia Velázquez, Ranking Member

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Small Business Index

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Introduction

During much of the 20th century, the U.S. economy was largely insular, driven in part by fluctuations in the domestic money supply, as well as the government's fiscal policies. In recent years, however, the United States economy has undergone significant change, resulting in an economy that is more dynamic and more complex than ever before.

While several developments have contributed to this evolution, two factors have been at the forefront of this marked change – the rise of economic globalization and dramatic increases in productivity. Together, these two factors are greatly influencing nearly all facets of the economy, including the duration and magnitude of the economy's business cycles.

The U.S. economy has become increasingly intertwined with the economies of foreign nations. In the United States, this is apparent in our foreign trade activity, as the real volume of U.S. trade has grown twice as fast as real output – bringing total trade from about 10 percent of GDP in the 1960s to over 25 percent of GDP in recent years.

The easing of barriers through multilateral and unilateral pacts has spurred the growth of international trade and the development of global telecommunications and transportation networks has connected remote parts of the world, permitting many countries to gain access to the international economy. As a result, U.S. businesses have been able to export their goods and services to more markets than ever before, and U.S. consumers are now able to purchase products in a marketplace of unparalleled diversity.

The rise of globalization has been accompanied by another significant economic development – substantial increases in productivity. The U.S has been enjoying significantly faster productivity growth for the past decade than it did over the preceding two decades. Since 1995, labor productivity has risen at an average annual rate of about 3 percent, up from an average annual rate of around 1.5 percent between 1973 and 1995. And in the past two years alone, output per hour has increased more than 5 percent per year.

Productivity increases have been driven by the adoption of new technologies and innovative processes, as U.S. businesses are able to produce more goods and services with fewer resources. As a result, employers can pay their labor force higher wages without raising prices. Consumers benefit from this phenomenon as well, as they are now able to purchase more goods and services without facing price increases.

Together, economic globalization and increases in productivity are fundamentally changing the structure of the U.S. economy. Now, the business cycle is not being driven by only domestic events and policies, but also external factors, such as trade balances and foreign exchange rates. In addition, productivity has emerged as a primary driver of business cycles – keying the expansion of the late 1990s – and permitting rapid economic growth without the risk of inflationary pressures.

The effects of these changes are significant for all segments of the economy, including small businesses that are often the catalyst for growth and expansion. In the 1989-1993 recession, small firms created approximately 3.8 million jobs, outpacing large firms by nearly 500,000 jobs. It was the laid-off, white-collar executive who was most likely to start a business, as roughly 25 percent of downsized managers over the age of 40 started their own firms during this period. Historically, small companies have led the way to recovery due to their ability to respond to sharp changes in economic conditions, spur job creation instead of layoffs, and maintain profits in an uncertain environment.

In an effort to better track the economic conditions facing small businesses and to provide policymakers with a means to evaluate economic proposals, the Democratic staff of the House Small Business Committee developed the Small Business Index (SBI). The SBI documents how small businesses are progressing in this new economy.

Initially released in September 2003, the SBI reflects the current small business climate, while also providing insights into near-term performance of the small business sector. The SBI pools information from various sources and includes broad measures of the economy, such as the federal budget deficit, number of unemployed and the producer price index, as well as those reflecting the cost of business, including energy and health care. To compare and contrast the changing economic conditions facing small businesses, the SBI has been calculated annually since 1998.

After reaching a high of 104.77 in 2000, the current 2Q 2004 SBI represents a seven-year low for the index, as conditions for small business creation and growth remain less than favorable. For the 2Q 2004, the SBI stands at 71.03, reflecting a downward slide since a brief period of increase in 3Q and 4Q 2003. Contributing to the SBI's recent decline are increases in oil prices and health insurance costs, a rising trade deficit, declining small business confidence, and a growing budget deficit. Increases in the Russell 2000 Index and venture capital funding, as well as rising manufacturers' new orders, partially offset the recent decreases in the SBI.

The current downward trend in the SBI reveals the challenging economic conditions for small businesses. Today, we are once again witnessing a prolonged economic downturn, marked by job loss across many industry sectors, including manufacturing, as well as ballooning trade deficits and rising costs for energy and health care. While stock market and consumer confidence measures have shown signs of recovery, recent statistics released by the Labor Department showed that U.S. employers are creating jobs at a pace well below that needed to sustain an economic recovery. Non-farm payrolls increased by only 144,000 in August – less than the 150,000 new jobs needed to accommodate new entrants to the labor market. In addition, the U.S. trade deficit increased to a record level of $55.8 billion in June. Given these factors, it is clear that small businesses continue to face substantial obstacles in the current economy.

The following report analyzes the various factors that constitute the small business economy and follows the trends that are indicative of entrepreneurial success. Through this analysis, recent policy choices can be evaluated and the need for future courses of action can be considered.

Analysis

Overview

The SBI illuminates the current challenges facing small businesses, as well as the impact that certain economic factors have had on entrepreneurial investment and growth. The current SBI rests at a seven-year low of 71.03, nearly 35 percent below its high point reached in 2000. Small businesses face an economy marked by several challenges, including rising business costs, a decline in commercial lending, and increasing competition from abroad. The current SBI reflects economic conditions that remain unfavorable for small business growth and expansion.

In contrast to the current SBI, the 2000 SBI marked a seven-year high of 108.8. Economic conditions in 2000 were favorable for small business growth as capital was more plentiful and operating costs were lower. The SBI declined precipitously in 2002 to 78.23, as gas and oil prices increased dramatically, commercial lending and venture capital activity declined, and the trade and budget deficits expanded.

3Q and 4Q 2003

Since 2002, the SBI has generally declined further, except for a brief period of increase in late 2003. In late 2003, the SBI benefited from low gas prices, as well an increase in net farm income, an improving stock market, and stable interest rates. However, 2004 has been marked by a return to a challenging small business economic environment – as health care, energy, and pension costs has increased substantially, the trade deficit has risen to record levels, and net farm income declined.

Findings

The most concerning aspect of the SBI is the downward trend of the last two quarters in 2004, despite the appearance of improving business conditions toward the end of last year. Although economists generally anticipated robust economic expansion, the weak growth during this time contributed to the relatively poor job creation. While many financial experts over the past few years have been “cautiously optimistic” for growth during 2003 and the early part of 2004, this has failed to materialize. The GDP numbers have continued to remain low, with the latest figures showing a modest growth rate of only 2.8 percent in the second quarter of 2004.

The SBI has tended to track the job creation and GDP numbers, which suggest that there will not be a significant upswing in the near future. Viewed in its entirety, the 2Q 2004 SBI shows that the near-term economic environment facing small businesses is not favorable going into the future. As the economy depends on small businesses to act as a catalyst for growth and job creation, the current SBI rating is troubling.

To further analyze the SBI, its 17 economic indicators used are grouped below into four categories: costs factors, credit conditions, trade competitiveness, and industry metrics.

Cost Factors

Health Care, Oil, Natural Gas, Retirement and Savings, and Total Employee Compensation, Producer Price Index, Regulatory Costs

In light of the increasing global competitiveness, the costs of inputs are a critical component of success for small businesses. The SBI data reveals that the overall cost of doing business has exceeded inflation, particularly for smaller firms, and it is getting increasingly higher. There have been substantial increases with respect to energy, pension, and health insurance prices that have increased the cost of operating a business.

While there has been some fluctuation, oil and natural gas costs have also been on the rise since 2000. Oil prices, in particular, over the last twelve months are reaching historic highs - nearly $50 per barrel. Small businesses are usually unable to negotiate wholesale rates on these goods and are particularly prone to price hikes. The dramatic rise in gasoline prices has impacted the many industries whose bottom lines are based on the rise and fall of these prices.

The third and fourth quarter of last year saw natural gas prices plateau, but the first and second quarters of 2004 have seen a slight run-up. While oil prices dipped in the third quarter of last year, they have risen by nearly ten percent in each of the last three quarters. These factors have contributed to the rise of the SBI during 2003 and its subsequent decline in the first half of 2004.

One of the most important cost factors for small businesses, health care costs, has risen each of the last four years. The SBI shows that these costs are reaching critical levels for small firms with double-digit premium increases occurring since 1999.

Besides health care and energy costs, other input factors had a more modest impact on the SBI over the last year. The Producer Price Index, which reflects the costs of goods paid by small businesses, leveled off over the last year and had little affect on SBI movement. Additionally, overall compensation and employee retirement costs have seen modest increases. It is unclear if this is reflective of a weak labor market or increased productivity. Finally, the increase in regulations by the federal government has moderated over the last year. Many firms have been spending increasing resources on compliance with these regulations and these costs often have a particularly harsh impact on small businesses.

Many of these cost statistics reveal that small businesses are receiving the same amount of inputs to run their businesses, but at a higher cost. These increased costs limit the ability of employers to purchase new equipment, hire new employees, and expand their business.

Credit Conditions and Access to Capital

Budget Deficit, Commercial and Industrial Loans, Interest Rates, Venture Capital

With an economy struggling to regain its strength, small businesses' access to affordable capital is critical. Business expansion, either through the addition of new facilities and equipment or through the hiring of new employees, is an essential component for sustained economic growth.

Small firms typically draw on capital in various forms, including revolving lines of credits, such as credit cards, as well as conventional bank loans. While interest rates have started to increase recently, they remain at or near historic lows. Even though rates have remained low, bank lending has stayed below the $1 trillion level it reached in 2000 and 2001. The lower levels of bank lending can be attributed to a combination of tighter lender requirements and small businesses' reluctance to take on additional debt in an uncertain economy. In many ways, this is indicative of the current economic slowdown, as banks and entrepreneurs are more risk adverse.

The SBI indicates that capital flowing to small businesses has been declining. The volume of commercial loans has declined dramatically in the past few years, from a high of nearly $1.1 trillion in 2000 to its current level of $875 billion. In the future, small businesses may continue to face difficulties in securing adequate capital, as growing budget deficits will contribute to the continued rise in interest rates.

While last year's budget deficit was $375 billion, this year the administration maintained their prediction for a larger budget deficit of $520 billion throughout the second quarter. While the end-of-year estimate was recently revised to $422 billion, it will be the largest budget deficit, adjusted for inflation, since World War II. Consequently, interest rates will rise as private sources of capital compete with the public sector for investors. As a result of these higher borrowing costs, small businesses will continue to face challenges regardless of the economy's growth.

At the end of June 2004, the Federal Reserve also increased the short-term Fed Funds rate for the first time in four years. Rising interest rates increase the cost of capital for doing business, but also have a more severe impact on small businesses that place a greater reliance on debt financing. Often, small firms are unable to finance operations through alternative funding arrangements, such as the equity markets, and are forced to pay higher interest costs to secure a loan.

Equity financing and venture capital funding are important sources of capital for many entrepreneurs. Through venture capital investment and accompanying management assistance, small businesses are often able to grow quickly and expand further into their targets markets. An increase in venture capital investment contributed to the brief and minimal rise in the SBI during the end of 2003. However, the current level of investment of $6 billion a quarter represents a substantial decline in venture capital funding from the nearly $27 billion a quarter in 2000.

Less than favorable credit conditions hinder small business owners' ability to expand their operations, market new products, or hire new employees. As a result, many small businesses are further distanced from the possibility of securing adequate capital and many of these firms will face higher financing costs or will be left unable to attain their business goals.

Trade Competitiveness of Small Businesses
Trade Deficit, Manufacturers' New Orders

As the U.S. economy's dependence on foreign goods and services increases dramatically, American small businesses are facing challenges to sell their products abroad. The trade deficits sharp increase has contributed to the decrease in the SBI from its transitory upsurge in 3Q and 4Q 2003. In 2003, the trade deficit averaged just less than $42 billion per month. In 2004, the trade deficit has risen sharply, averaging over $45 billion a month, with a record deficit of over $55 billion for May.

The rising trade deficit is indicative of the increased flow of foreign imports into the U.S. and a decrease in U.S. exports. As foreign imports grow, domestic small businesses are faced with greater competitive pressure that ultimately reduce their profit margins. Because many small businesses rely on foreign markets as a source of revenue, a reduction in U.S. exports may force a small business to curtail its operations, or even close their doors.

Manufacturers' new orders, a benchmark measure of the domestic manufacturing industry, has increased recently from 330 billion to 360 billion new orders, showing signs of resurgence for the industrial sector. While this increase in activity is a positive development for small manufacturers, it is unclear if this trend will be sustained.

As the majority of U.S. exporters are small businesses, the rising trade deficit has a disproportionate affect on them. Failed trade policies and barriers to small business growth have significantly contributed to the SBI's decline. Without policies that level the play field, small businesses will be unable to expand their operations, employ more workers, and contribute to their local economy's growth.

Industry Metrics
NFIB Small Business Optimism Index, Net Farm Income, Russell 2000 Index, Total Unemployed

The SBI also includes factors that measure the performance or health of the small business sector. The Industry Metrics reveal what entrepreneurs can expect if they choose to start or expand a business. These indicators are designed to show small businesses confidence in the economy and whether they are expanding or are planning to hire new employees. These figures include the NFIB's Small Business Optimism Index, a small company stock index (Russell Index), net farm income and the overall number of unemployment.

The Industry Metric that has had the most significant movement over the last year has been net farm income. This factor, which tracks the economic condition of rural America, saw significant growth in the second half of last year – particularly in the fourth quarter with a 34 percent growth rate. A precipitous drop in net farm income followed this in the first and second quarters of 2004.

In terms of the overall business "mood" for small firms, the NFIB Optimism Index shows that small businesses are reacting poorly to the current economic conditions and have a lower level of optimism. This is reflected by the recent decline in this index's value from nearly 107 at the end of 2003 to 103 in June 2004. This is concerning as many firms base hiring and expansion plans on their expectations of the future economic environment.

The inclusion of unemployment figures reflect the hiring patterns of small firms. While the number of unemployed saw a significant drop in the third quarter of last year, it has remained stagnant since that time. This is significant because in past business cycles, there have been significant increases in hiring.

The benchmark small company stock index also tends to track with the overall SBI. This index, the Russell 2000, rose significantly at the end of 2003, but the growth rate has since fallen off. The rise in the Russell 2000 contributed to the increase in the SBI in the fourth quarter of last year, while having a minimal effect on the decline seen in the last two quarters.

These indicators show that firms are not hiring and the prospects for future workforce expansion and growth are tempered. These also provide a reflection of the health of small firms in the last year and display the significant slowing down of small business growth in the first half of 2004.

Conclusion

The greatest concern facing the U.S economy today is its failure to sustain a broad recovery. After what appeared to be an upswing at the end of 2003, the economy has since retreated. While many economists were optimistic about U.S. economic prospects toward the end of 2003, the economy began to falter shortly thereafter, as evidenced by the current SBI of 71.03, and the lack of robust job creation.

Historically, after periods of an economic downturn or recession, such as that experienced in late 2001 and early 2002, the U.S. economy has recovered, typically generating substantial GDP growth and job creation. This was seen in the recessionary period of the early 1990's where industries ultimately adapted to the changing needs of the economy, created new jobs, and eventually led the economy forward.

Such economic rebirth is a fundamental characteristic of the U.S. economy. Innovation and progress yield new ideas, which in turn create new companies and employment opportunities. Ultimately, as seen throughout the 20^{th} century, entire new sectors are created – the automobile industry in the 1920s, the energy and housing industries in the 1950s, the telecommunications industry in the 1960s and 1970s, and the rise of the dotcom industry in the 1980s and 1990s. These sectors provide the economic foundation for the U.S., providing jobs for workers and tax revenue for local communities. Commensurate with this economic strength, the SBI reached its all-time high of 108.80 in 2000.

Due to a variety of factors, anticipated economic renewal is not taking place, rather, the current economic landscape is stifling business creation and expansion. Rising business costs and the shortage of available capital have made many small businesses reluctant to expand. These costs impose constraints on the ability of businesses to maintain profitability. Contributing to these concerns are ever changing geopolitical forces, which add yet another layer of uncertainty for small firms. For those entrepreneurs that have been able to weather these rising costs, many face additional difficulties in securing capital, as represented by a decline in bank lending.

Given the current economy's situation, it appears that the tools are not in place to encourage investment and business growth. The typical business cycle of rapid expansion is driven by a combination of factors, including market forces as well as economic policies that foster innovation and expansion. Recent job figures have economists calling into question the economy's ability to reinvent itself yet again, and create the industries needed to lead America forward.

Domestic initiatives and policies have not allowed firms, particularly small businesses, to allocate resources toward new investments and innovations. During the last year, health care and energy prices rose in excess of ten percent, with particularly pronounced increases in oil prices over the last few quarters. These rising costs have forced many firms to stop expansion of their operations and also prevented many budding entrepreneurs from launching new businesses.

There has been little effort by the current administration to rein in these costs, which is reflected in the SBI. In recent months, there has been bipartisan recognition that the rising cost of inputs is having a dampening effect on the economy. While administration officials recently noted that rising health care and oil costs have created a difficult business environment, the administration's inaction on these fronts has contributed to the deterioration of current economic conditions, as seen in the most recent SBI of 71.03.

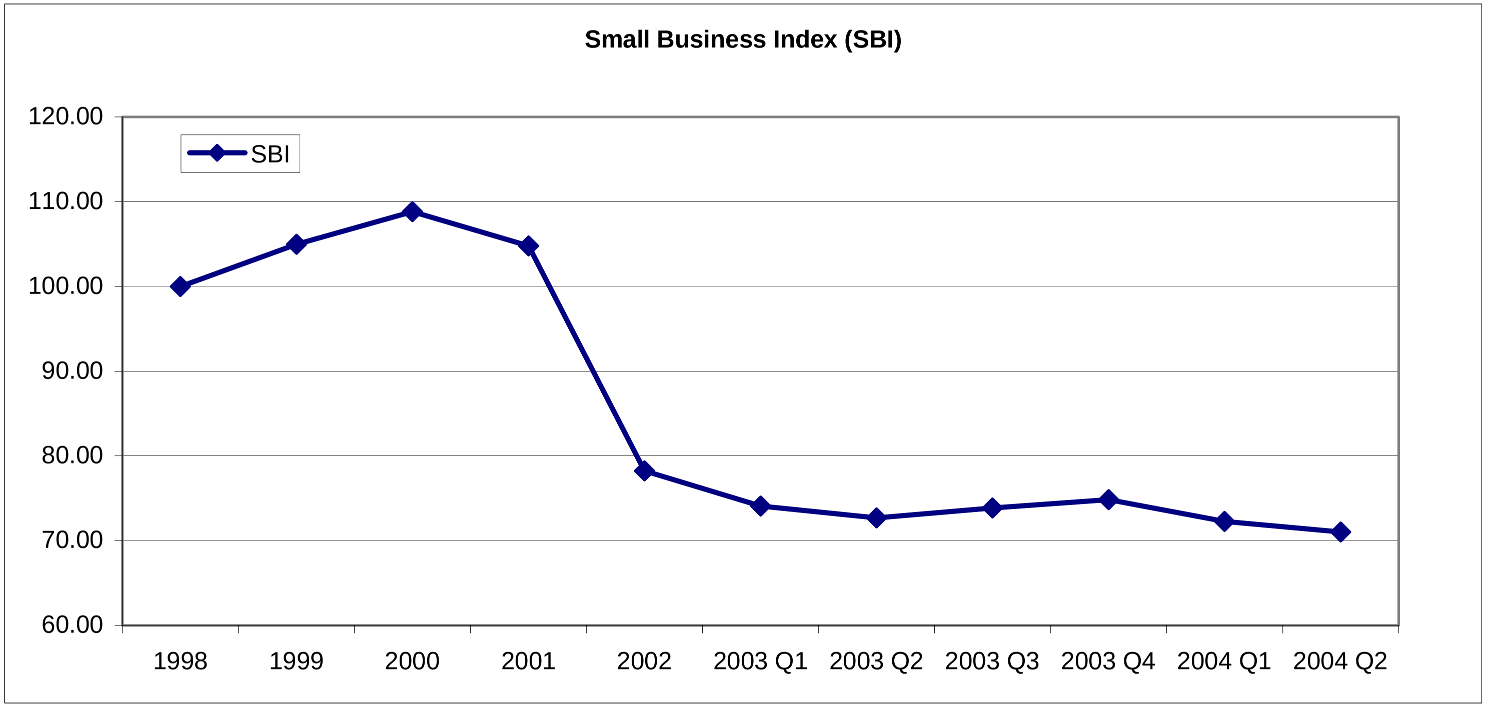
Another challenge facing the economy is the lack of incentives for investment in new ideas and burgeoning firms. The administration's economic policies during this period of weak economic growth have focused on preserving the status quo, instead of promoting entrepreneurial expansion. In fact, the only significant economic policy initiative enacted in the last three years has been a series of tax cuts that have increased the deficit while providing little benefit to small businesses and entrepreneurs. An effective tax policy would encourage investment and generate economic growth, rather than direct capital to existing companies.

While it appears that these tax breaks provided a short-term stimulus in the fourth quarter of 2003 as shown in the SBI, which reached 74.84, they have failed to provide a lasting boost to the economy. The minimal rise in the SBI during this period and its subsequent decline to 71.03 is indicative of the short-term impact of the tax cuts. Given that over half of small businesses saw less than $500 from the tax cut, it is not surprising that there has been no permanent, long-term effect on the economy.

As the economy is operating in a dynamic environment, marked by globalization and dramatic increases in productivity, so must U.S. economic policy. The policymaking process must be adaptable to the changing economic environment so that new entrepreneurs can be drawn into the economy. The current SBI exposes an economy that is struggling to recover, indicates modest investor appetite, and highlights the ineffectiveness of current economic policies. These policy choices are impeding the free flow of investment into new industries and are obstructing the efficient allocation of capital, as rising costs are restraining business growth or forcing businesses into bankruptcy.

In order to reverse the downward course of the SBI and reinvigorate our country's entrepreneurial spirit, America needs a visionary economic policy that will provide both the resources and incentives that encourage innovation and the development of new ideas. It is only through the empowerment of entrepreneurs that our nation will be able to move forward and reach new heights.

Data



	1998	1999	2000	2001	2002	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2
Small Business Index (SBI)	100.00	104.97	108.80	104.77	78.23	74.10	72.70	73.88	74.84	72.28	71.03

Methodology

The SBI is comprised of a basket of economic indicators. These indicators provide a broad measure of the degree of small business creation and viability by representing the characteristics necessary for a healthy domestic small business sector. An increasing SBI is indicative of an improving small business sector. The data is gathered and compiled quarterly from various sources, including government agencies, congressional sources, and private institutions. The report is generally released annually.

The SBI is what is generally known as a coincident index, in that it reflects the current economic conditions facing small businesses. In order to expand the scope of the economic environment measured by the SBI, both leading and lagging indicators are included. Leading indicators are commonly used to predict changes in economic activity, whereas lagging indicators typically confirm previous changes in the economy. By using both types of data, the SBI demonstrates not only the current state of small businesses, but also how strong the environment is for starting new ventures.

The SBI is calculated using both broad economic measures as well as more specific indicators showing the health of the small business sector. Broad economic measures incorporate the effect of changes in aggregate economic conditions, such as inflation, employment, and trade balances. The sector specific indicators track changes in the costs associated with operating a small business, such as health care and energy costs. Together, this combination of indicators provides an expansive measure of the small business economic environment.

Since the initial SBI was released in 2003, the index's indicators have been reviewed and updated to ensure that the SBI remains the most accurate measure of the small business economy. Business starts and failures, which were used as a broad measure of small business confidence in the economy, were removed from the index due to the substantial lag in the issuance of the data series. In place of these variables, NFIB's benchmark Index of Small Business Optimism was incorporated into the SBI to measure small business owners' views of and confidence in the economy. Finally, the SBI's energy indicators were refined to more accurately capture the costs of the energy resources most relied on by small businesses – oil and natural gas.

For each economic indicator, data is used to calculate a percent change. This change is calculated quarterly beginning in 2003. For the five-year period between 1998 and 2002, the SBI was calculated annually. The change in each indicator is used as the basis for computing the SBI.

Understanding that not every indicator positively affects the economic conditions facing small businesses, each indicator is assigned a positive or negative correlation. Positive indicators contribute to more favorable economic conditions for small businesses, whereas negative indicators weaken their economic environment. The correlation determines whether the SBI will increase or decrease given a change in the value of each economic indicator.

The average percent change of the basket of economic indicators is then calculated. For this calculation, each economic indicator has an equal statistical weight. This average percent change is used to increase or decrease the SBI.

Indicators

Balance of Trade represents the net amount of domestic international trade, as the combination of the number of imports and exports. A trade deficit occurs when foreign imports exceed domestic exports. Conversely, a trade surplus occurs when domestic exports exceed foreign imports.

While trade deficits have helped contain inflation during periods of economic growth, they produce many challenges to domestic manufacturers and exporters, the majority of which are small businesses. For these domestic small businesses, trade deficits often signal a lack of global competitiveness and a loss of market share. Larger corporations are better able to move their operations abroad, reducing their exposure to the factors that cause trade imbalances. Small businesses, however, are unable to easily relocate overseas and must reduce their operating costs or change their business model.

Commercial and Industrial Loans and Leases reflect the amount of business lending by commercial banks. Small businesses, including small manufacturers, rely on commercial and industrial loans to expand their operations and to modernize their facilities. These loans are used to purchase real estate and equipment, as well as for working capital purposes.

The measure of commercial and industrial lending and leasing activity provides a good gauge of the credit conditions facing small businesses. An increase in lending and leasing indicates that banks are willing to extend more credit, while a decrease represents a tightening, or rationing, of credit. Because bank lending patterns also reflect the financial conditions of their borrowers, a change in this measure is often correlated with the underlying economic fundamentals of the business sector.

Federal Budget Surplus or Deficit represents the net amount of federal government outlays and receipts. A budget deficit may negatively affect small businesses for two reasons. First, it may be indicative of a decrease in federal government domestic discretionary spending, including reductions in programs targeted to assisting small businesses and entrepreneurs. For instance, budget deficits are likely representative of reductions in many of the Small Business Administration's (SBA) programs, as well as programs that provide vocational training to adults, energy and technological support to companies, assistance to small manufacturers, and mentoring opportunities to minority-owned businesses.

Second, budget deficits contribute to higher credit costs. As the supply of government debt is increased, the price (interest rate) on the debt must also be increased in order to attract investors. To remain competitive, private sector debt issuers often raise the interest rates on their instruments as well. The result is higher interest rates for all borrowers. Borrowers who rely on commercial loans, such as small business owners, are most likely to be hurt by these interest rate increases.

Health Care accounts for the cost of health care insurance premiums. The indicator represents the price companies pay for providing health care to their employees. It is a combination of the cost of health care supplied by all providers (HMO, PPO, and point of service). While small businesses are not required to provide health care to their employees, most do so in order to retain qualified workers. As with any workforce benefit, changes in the price of health care have a direct impact on the company's bottom line. For small businesses, increases in these costs can lead to either a reduction in coverage offered or other forms of compensation, and can have a detrimental affect on the stability of the company.

Manufacturers' New Orders represent the amount of orders for durable and non-durable goods placed with domestic manufacturers, the majority of which are small businesses. Manufacturers' new orders are a benchmark for economic activity, often signaling a near-term economic recovery or downturn.

A rise in manufacturers' new orders reflects an upturn in economic activity and is a likely indicator of a rise in near term profitability. A decrease in manufacturers' new orders is indicative of a decline in business, which will result in lower profits for manufacturing businesses.

Natural Gas Costs are the average monthly price of natural gas sold to consumers in the United States. These figures are taken from the U.S. Energy Information Association. The amounts are measured in dollar amounts per cubic foot.

For many small businesses, the costs of energy, including natural gas, make up a significant percent of their daily operating costs. Spikes in natural gas prices can be devastating to certain sectors of the economy. These price increases are particularly tough on gas-intensive businesses like small restaurants and dry cleaners. Federal Reserve Chairman Alan Greenspan and other economists have cited the rising costs of natural gas as an impediment to economic growth.

NFIB Small Business Optimism Index is a composite measure of ten qualitative small business survey indicators and generally reflects small businesses' views of the economy. The index is based on monthly surveys of NFIB members.

Net Farm Income is a measure of the financial condition of the farm industry. It reflects the farm income received from the sale of livestock and crops, as well as payments from the government less the production expenses. Farms often drive rural economies, providing jobs to local residents and generating wealth in these communities. As a result, the economic well-being of rural small businesses is frequently tied to local farms.

An increase in net farm income is indicative of an improving rural economy. Growth in net farm income often translates into higher profitability for rural small businesses. Alternatively, a decline in net farm income often signals tougher times for small firms, as farms purchase less goods and services from local rural small businesses.

Number of Unemployed represents the number of individuals without jobs, indicating the level of small business economic activity. A decline in the number of unemployed reflects an improving economy, in which more consumers have the means to purchase goods and services. An increase in the number of unemployed indicates a slowing economy, in which consumers are less able to spend freely on goods and services.

Oil Costs pertain to the sweet crude oil costs in U.S. dollars per barrel. Such figures are compiled by the New York Mercantile Exchange Index and are posted by the U.S. Department of Energy. As many small companies are dependent on transportation costs, changes in gasoline prices can severely affect the cost of doing business. In addition, price volatility of oil can make it difficult for small businesses to decide on future investments due to cash flow issues related to these rising costs.

Prime Rate is the interest rate charged by banks to their most creditworthy customers. Interest rates on small business loans are generally tied to the prime rate. The prime rate is included as a measure of the credit terms available to small businesses. While the prime rate is directly charged to the most creditworthy small businesses, the interest rates charged to less creditworthy small businesses are increased and decreased according to this rate. This demonstrates how the prime rate affects the lending conditions of nearly every company.

The prime rate fluctuates based on the federal funds rate and other factors. The prime rate provides the lender with sufficient revenue to cover the costs associated with loans to borrowers determined to have a low risk of default. The rate is adjusted in increments, called the margin, to compensate for greater credit risk or other factors that affect the cost of lending.

Producer Price Index (PPI) measures the average change over time in the selling prices received by domestic producers for their output. The PPI represents the prices that small manufacturers and producers will receive for their products. In addition, the PPI also measures the prices charged to small businesses for purchases of their retail inventory.

Rising resource and labor costs often cause the PPI to increase and may result in a reduction in the demand for small businesses products, dampening economic activity. A decrease in the PPI reflects declining costs of production and may cause small businesses to lower their prices or increase their profit margins.

Regulatory Costs represent the total number of final regulations issued each year. This measure is used as a general indicator for small business regulatory burden. Regulatory compliance and paperwork consistently rank as one of the top ten costs facing small businesses in America today. Costs to small firms for regulatory compliance are generally 60 percent higher than they are for large firms.

Retirement and Savings represent the costs for small businesses to provide employee pension benefits per working hour. These costs are associated with the amount spent in offering retirement coverage, a critical tool in attracting and retaining employees.

Russell 2000 Index represents the 2,000 smallest companies in the Russell 3000, a broad based index that represents approximately 98% of the value of what is invested within the U.S. equity market. The Russell 2000 makes up only about 8% of the total market capitalization of the Russell 3000. This is the most quoted index that focuses on the smaller company portion of the economy.

While most small businesses are not publicly traded, the Russell 2000 Index is a benchmark measure of the economic performance of smaller companies. An increase in the Russell 2000 reflects rising investor confidence in the smaller company sector and heightened expectations for future profitability. A decline in the Russell 2000 is generally driven by decreased investor confidence and lower profit expectations for the Index's companies.

Total Employee Compensation accounts for what small businesses spend on employees for each hour worked. This number represents the compensation for companies that have 99 employees or less, and is a combination of salary, benefits, and government paycheck requirements. This measure does not account for employee retirement costs.

Cost increases for small businesses can have a detrimental affect on them, since many operate on very thin profit margins. An increase in the cost of each employee hour worked can force small firms to make cuts or raise their product's price. When the cost of each hour worked decreases, small businesses have more flexibility in running their companies, as they are able to provide more benefits, hire additional workers, or save money for a later date.

Venture Capital reflects the amount of equity investment in private companies, the majority of which are small businesses. Equity capital is an important financing element for entrepreneurs seeking to improve their business model, expand their operations, and reach new customers.

Venture capital activity is beneficial to small enterprise because it provides a source of long-term capital investment. Any increase in venture capital investment is beneficial to small businesses, as it provides another source of financing. A rise in venture capital financing is also symbolic of increased innovation and entrepreneurship. On the other hand, a decline in venture capital financing increases the likelihood that small businesses will have to rely on more costly financing arrangements, such as high interest credit cards.